UNITED STATES DISTRICT COURT
DISTRICT OF RHODE ISLAND

JUDITH A. LAWTON, THOMAS LAWTON,
MARSHA E. DARAS, STEPHEN H. LAWTON,
NANCY LAWTON CRONIN, DAVID T. LAWTON,
T. MICHAEL LAWTON, JOANNA J. LAWTON,
and SUZANNE M. LAWTON
plaintiffs,

v. CA No. 98-288-T

ROBERT C. NYMAN, KEITH JOHNSON,
KENNETH J. NYMAN, and NYMAN
MANUFACTURING, INC.,
defendants.

DECISION

Judith A. Lawton, her husband Thomas, and seven of their adult children (the "Lawtons" or "plaintiffs"), brought this action against Nyman Manufacturing Company ("Nyman Manufacturing"), a closely held corporation in which the plaintiffs were minority shareholders; Keith Johnson; and Judith's two brothers, Robert C. Nyman and Kenneth J. Nyman (the "defendants"). The plaintiffs allege that the defendants breached their fiduciary duty as directors and officers of Nyman Manufacturing, and that the defendants committed securities fraud and common law fraud. The plaintiffs claim that the defendants caused the plaintiffs' shares to be redeemed for less than their true value by misrepresenting and failing to disclose various material facts regarding the value of those shares. More specifically, the plaintiffs claim that the defendants (1)

violated Section 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 of the applicable SEC regulations, 17 C.F.R. § 240.10b-5; (2) breached their fiduciary duties as officers and directors of the corporation; (3) committed common law fraud; (4) made negligent misrepresentations; and (5) were unjustly enriched by their actions.

After listening to the witnesses and examining the voluminous exhibits presented during a lengthy bench trial, this Court finds that the defendants breached their fiduciary duties by causing the plaintiffs' shares to be redeemed for less than their true value without disclosing their expectation that the company would be sold. Therefore, judgment will be entered in favor of the plaintiffs in the amount of $2,096,798.48, plus interest.

Findings of Fact

I. Background Facts

The facts in this case are virtually identical to those found by this Court in Kiepler v. Nyman, C.A. No. 98-272-T. (See decision dated January 18, 2002.) That is not surprising inasmuch as the two cases arise from the same events and, for the most part, the same witnesses and exhibits were presented during both trials. Indeed, the overlap and resulting

duplication of time, effort, and expense were so great that this Court deeply regrets not having consolidated the cases, as it originally intended, when counsel expressed their opposition to consolidation.

A. The Early Years

Nyman Manufacturing was a Rhode Island corporation that manufactured paper and plastic dinnerware at its facility in East Providence, Rhode Island. The company was founded in 1936 by John Nyman, and, until 1997, it was owned and managed by members of the Nyman family.

Nyman Manufacturing's articles of incorporation authorized the issuance of 13,500 shares of Class A non-voting stock and 1,500 shares of Class B voting stock. Throughout the company's existence, all of the issued and outstanding shares of Class B stock were owned by one or two family members who served as the company's officers and directors and actively managed its business. Ownership of the issued and outstanding shares of Class A stock was more widely dispersed among all of the family members. A few of the Class A shareholders, including Judith Lawton, were employed by Nyman Manufacturing at various times, but most of them were not actively involved in the company. No dividends ever were paid on either class of stock.

Historically, the Class B shareholders made decisions

without consulting the Class A shareholders, and the Class B shareholders provided very little information about the company's operations or financial condition to the Class A shareholders.

When John Nyman died, control of the company passed to his sons Walfred and Ralph. Walfred had four children: Robert, Kenneth, Beverly (Nyman) Kiepler, and Judith (Nyman) Lawton. In the late 1980s, after Ralph and Walfred had died, Robert and Kenneth inherited all of the 750 shares of Class B stock then issued and outstanding. Robert and Kenneth also became Nyman Manufacturing's president and vice-president, respectively, as well as members of what, then, was the company's three-member board of directors.

B. The Lean Years

Around that same time, Nyman Manufacturing began experiencing financial difficulties. The company lost money for four consecutive years and, by 1994, it was on the verge of bankruptcy. Robert and Kenneth, who previously had been well-compensated as company executives, were forced to reduce their salaries and relinquish some of their fringe benefits, including their rights in a fixed-benefit pension plan. In response to demands by Fleet National Bank, the company's principal lender, Robert and Kenneth also personally guaranteed $1 million of the

company's debt.

C. The Arrival of Keith Johnson

In August 1994, Robert and Kenneth were in their fifties, and there were no younger family members who were active in managing the business and were prepared to succeed them. In an effort to restore the company to profitability, the Nyman brothers hired Keith Johnson, who also was in his fifties, as the company's treasurer and chief financial officer.

Johnson had considerable experience in managing manufacturing businesses and was very knowledgeable with respect to financial matters. Since the company was in no position to offer Johnson the kind of salary that he ordinarily would have commanded, the Nyman brothers induced him to accept employment by promising him an equity stake in Nyman Manufacturing if he could help to "turn the company around."

About a year later, Fleet terminated its relationship with Nyman Manufacturing and Johnson obtained alternative financing from CoreStates Bank, N.A. ("CoreStates") and Heller Financial, Inc. ("Heller"). During his discussions with Heller, Johnson mentioned the possibility that Nyman Manufacturing might be sold.

D. The Acquisition of Options and Stock

When Johnson was hired, Robert and Kenneth each owned 375

shares of the 750 shares of Class B voting stock then issued and outstanding. The 8,385 shares of Class A non-voting stock then issued and outstanding were owned by Robert, Kenneth, Beverly and Judith; their spouses and children; a testamentary trust established by Walfred Nyman for the benefit of his wife and four children; and the estate of Magda Burt, Walfred's sister, who died in 1987. The executors of Magda Burt's estate had made several attempts to interest Nyman Manufacturing in redeeming the estate's shares, but those overtures were rebuffed with the explanation that the company did not have sufficient funds to purchase the shares.

By early 1995, Nyman Manufacturing's fortunes had improved and, for the first time in the company's history, the Board of Directors adopted a stock option plan for the stated purpose of rewarding executives for meritorious performance. On April 3, 1995, the Board, which consisted of Robert, Kenneth, Keith Johnson and Manuel Paiva, Nyman Manufacturing's Secretary, granted Johnson an option to purchase 1,000 shares of Class A stock at an exercise price of $145.36 per share. That price was pegged at an amount equal to 80% of the shares' book value. It was arrived at by dividing total shareholder equity by the number of shares then issued and outstanding and discounting the resulting per share value by 20% to reflect the fact that the

shares constituted only a minority interest in the company.

Around that same time, Nyman Manufacturing embarked on a program to "re-purchase shares of the Company" in order to "eliminate any shareholders who are not active in day-to-day operations of the Company." Pltf.'s Ex. 216. That decision to redeem shares was made even though the company had pressing needs and was laying off workers in order to conserve money.

Since it was necessary to use borrowed funds to purchase the stock, Nyman Manufacturing was required to obtain permission for the purchases from Heller and CoreStates. That permission was granted and the company offered to redeem the 2,256 shares of Class A stock owned by the estate of Magda Burt for $145.36 per share. In arriving at that figure, the defendants made no effort to have the shares formally appraised. Rather, they offered a price that was the same as the exercise price of the options previously granted to Johnson.

On November 6, 1995, the Burt shares were redeemed. That same day, the defendants voted themselves options to purchase 2,256 shares of Class A stock, also for $145.36 per share. Robert received options to buy 1,128 shares while Kenneth and Keith Johnson received options to purchase 564 shares each.

Two months later, in January of 1996, Nyman Manufacturing offered to redeem the 1,677 Class A shares owned by the Walfred

Nyman Trust, once again, for $145.36 per share. That offer never was accepted because Beverly Kiepler, one of the beneficiaries, felt that the shares were worth more and she objected.

Nyman Manufacturing's 1996 fiscal year ended on March 29, 1996. During that year, the company made a profit of $3.5 million and shareholder equity quadrupled. However, much of the increase was attributable to non-recurring items such as the gain realized on the sale of machinery and equipment from a facility in Georgia that had been closed.

After reviewing the year's unaudited results, the Board voted to adopt deferred compensation plans for Robert, Kenneth, and Keith Johnson. Those plans had a total value of $2,000,000. The Board also decided to hire a consultant and authorized Keith Johnson to begin interviewing prospective candidates.

Approximately a month later, Johnson talked to Beverly Kiepler about the possible redemption of her shares. He told her that the loan restriction waivers obtained from Heller and CoreStates that allowed Nyman Manufacturing to redeem shares "will expire on May 1." Pltf.'s Ex. 222. In fact, such waivers were not even obtained until May 30. CoreStates did not specify any expiration date and the expiration date specified by Heller was not until July 29, 1996. See Pltf.'s Ex. 238.

In May 1996, shortly before the audited financial statements for fiscal year 1996 became available, the company offered to redeem all of the issued and outstanding shares of Class A stock except those owned by the Nyman brothers, their spouses, and the Walfred Nyman Trust. The price offered was $200 per share which shareholders were told was the price paid for the Burt shares plus an amount to cover any taxes that they might incur on the sale.

Johnson sent letters to Judith Lawton, members of Lawton's family, Beverly Kiepler, and Kristen Branch, stating that "the Company has had major earnings 'ups and downs' over the past 10 years including 5 years in which significant losses were experienced. In the two most recent years, the Company's financial condition has improved and its lending banks have agreed that limited amounts of its common stock may be re-purchased." Pltf.'s Exs. 225-228. The letter went on to describe the offer as "an opportunity for shareholders who are interested in achieving liquidity now," but cautioned that "since the company cannot provide you with any advice as to whether the sale of the stock by you is in your best financial interest, we suggest that you discuss this matter with your financial advisor." The letters also set May 22, 1996, as the expiration date for the offer, even though, as previously

stated, CoreStates had imposed no deadline and Heller's deadline was July 29.

On May 10, 1996, two days after Johnson's letter was sent, Robert Nyman called Judith Lawton to verify that she had received the letter. Robert told Judith that the value of the stock could go up or it could go down. He also told her this was a "once in a lifetime" opportunity to sell her stock. Neither Robert nor Keith Johnson mentioned any possibility that Nyman Manufacturing might be sold.

That evening most of the Lawton family gathered at Judith's home and Judith related what she had been told. After discussing the matter over the weekend, all of the plaintiffs decided to sell their shares and signed certificates assigning the shares to the corporation.[1]

Although Judith Lawton had a financial advisor, stock broker, and accountant, she did not consult any of them about the company's offer. Nor did she ask to examine any of the company's records or financial statements even though, in the past, Johnson had been cooperative in providing any information that she requested.

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[1] Although the certificates are dated May 9, this Court credits the testimony that the date was erroneously inserted by one of the Lawton children and the others simply followed suit.

In any event, the 952 Class A shares owned by the Lawtons were redeemed on May 30, 1996 for $200 per share.[2] One hundred forty Class A shares belonging to children of Robert and Kenneth also were redeemed for the same price. See Pltf.'s Ex. 288.

Less than one month later, on June 25, 1996, the defendants voted themselves options to purchase 1,092 Class A shares, the same number redeemed from the Lawtons and the children of Robert and Kenneth. Robert received options to buy 432 shares while Kenneth and Keith Johnson each received options to buy 330 shares. The option price for Johnson's shares was $200 per share, the same price paid to redeem the 1,092 shares. The option price for the Nyman brothers' shares was $220 per share because the stock option plan previously adopted required majority shareholders to pay 110% of "fair market value."

Once again, the defendants made no attempt to formally appraise the stock. Nor did they calculate the exercise price as 80% of book value, as had been done when the April 1995 options were awarded to Johnson. Had that approach been taken, the exercise price would have been considerably higher because the book value of Nyman Manufacturing's stock had increased from

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[2] Judith Lawton owned 584 Class A shares; her husband, Thomas, owned 88 Class A shares; and each of the Lawtons' eight children owned 35 Class A shares. However, only seven of the Lawton children are parties in this action. Therefore, the total number of shares owned by the plaintiffs is 917.

$181.70 per share in April of 1995, to $527.50 per share in June of 1996.

On June 25, the defendants also purchased all of the 4,115 shares of Class A stock remaining in the treasury, and the Nyman brothers purchased all 750 shares of Class B treasury stock. More specifically, Robert purchased 1,675 Class A shares and 375 Class B shares; Kenneth purchased 1,250 Class A shares and 375 Class B shares; and Keith Johnson purchased 1,190 Class A shares. All of the treasury stock was purchased for $200 per share. The June 25 transactions may be summarized as follows:

Name	Class A Stock Options Received	Treasury Shares Purchased	
		Class A Non-Voting	Class B Voting
Robert Nyman	432	1,675	375
Kenneth Nyman	330	1,250	375
Keith Johnson	330	1,190	0
TOTAL	1092	4,115	750

The defendants “paid” for the treasury shares with unsecured promissory notes totaling $973,000.00 that called for annual interest payments to be made commencing on June 30, 1997. Because the “payment” for those shares increased shareholder equity as shown on the company’s books, the Nyman brothers were able to obtain releases from the personal guarantees that they

previously had given.

E. Arranging to Sell the Company

In August of 1996, less than two months after the purchase of the treasury shares, Keith Johnson and Robert Nyman met with Scott Wilson, the Managing Director of Shields and Company, Inc., ("Shields & Co."), a consulting firm. While it is not clear whether a decision already had been made to hire Shields & Co., the parties discussed the services to be provided by Shields & Co., which included "maximiz[ing] Nyman's position in the future in the eyes of a potential acquirer;" advising Nyman with respect to "the specific dynamics of the merger and acquisition market;" and assisting Nyman "in responding to the numerous acquisition inquiries when appropriate." Pltf.'s Ex. 261. The defendants' interest in the possibility of selling the company was confirmed the following month, when Johnson informed Heller that a sale of Nyman Manufacturing was likely to occur within the next five years. See Pltf.'s Ex. 267.

In October 1996, Johnson met with Thomas Shields and told him that the Van Leer Corporation, a Dutch company whose U.S. subsidiary, the Chinet Company, was one of Nyman's competitors, had funds available to acquire other companies. A month later, Shields & Co. wrote to Johnson regarding the matters discussed

at that meeting. The Shields letter stated that "We want to develop a list of potential buyers/investors," and it identified "the universe of potential buyers in the next three years" to include several categories of "strategic" and "financial" buyers, some of which were identified by name. One of the categories of "strategic" buyers was described as "Foreign strategic buyers such as Warrington and Van Leer with significant overseas operations and with a strategy to expand their activity in North America." Pltf.'s Ex. 276 (emphases added).

As Shields' letter suggests, and as William Piccerelli, Nyman Manufacturing's business valuation expert, later testified at trial, a "financial" buyer is one that intends to operate the company being acquired as a free-standing, independent enterprise; and, therefore, bases its offering price on the target company's intrinsic or fair market value, which is the amount that would be paid by a hypothetical buyer having knowledge of the relevant facts regarding the operation of the business. By contrast, a "strategic" buyer is a particular buyer to which the target company has a unique investment value that is greater than its market value because acquisition of the target company would fulfill some strategic need or goal of the buyer. Ordinarily, a strategic buyer is one that is engaged in

the same business as the target company, thereby creating the possibility that the acquisition may complement the buyer's business, result in economies of scale, reduce competition, and/or present other synergistic opportunities. In this case, Van Leer was identified as a potential strategic buyer because its subsidiary, Chinet, competed in some respects with Nyman and likely would be interested in expanding its product line and production base in the United States.

The following January, Johnson had further discussions with Scott Wilson regarding the amount for which Nyman Manufacturing might be sold; and in March, he traveled to The Netherlands to meet with Van Leer officials. According to Johnson, his purpose was to explore the possibility of cooperative ventures between Nyman Manufacturing and Chinet and to convince Van Leer to invest $4 million in Nyman Manufacturing. However, Kenneth understood that the purpose was to arrange for the sale of Nyman Manufacturing's business. In any event, during those meetings, Van Leer offered to purchase Nyman Manufacturing, and on June 25, 1997, a letter of intent was signed providing that Van Leer would purchase all of Nyman's outstanding stock for the sum of $30 million.

F. The Closing

The losing took place on September 29, 1997, and it was not

until then that the defendants paid the first installment of interest due on the promissory notes that they had given for their purchase of treasury shares, even though the payment had become due on June 30, 1997.

The gross sale price for all of Nyman Manufacturing's stock was $28,164,735.00. The uncontradicted evidence is that, upon the advice of tax counsel, Van Leer made two requests regarding the manner of payment. First, it requested that the defendants not exercise their options and, in return, Van Leer agreed to treat the options as shares of stock. Van Leer also requested that the price of each Class B share be fixed at 1.3 times the price of each Class A share. The defendants agreed to both requests.

After deducting closing costs of $980,383.00 and the amount of $1,423,331.00 escrowed to satisfy Nyman Manufacturing's potential liability for remediating a hazardous waste site where some of the company's refuse had been deposited, the net amount ultimately was paid to shareholders was $25,761,021.00.[3] Accordingly, $1,667.38 was paid for each of the 13,500 Class A shares and options and $2,167.59 was paid for each of the 1,500 Class B shares. Approximately $300,000, currently, remains in

[3] According to the closing documents, $3,000,000 was escrowed. However, it appears that $1,576,669 was distributed to the shareholders sometime after the closing.

the escrow account, and it is uncertain whether any of that money will be available for future distribution to shareholders.

The amounts paid to shareholders for their stock and options were as follows:

Shareholder	Number of Class A shares @ $1,667.38	Number of options for Class A shares @ $1,667.38	Amount received for Class A shares and options	Number of Class B shares @ $2,167.59	Amount received for Class B shares	Total Amount Received
Robert Nyman	2,817	1,560	$7,298,122.26	750	$1,625,692.50	$8,923,814.76
Kenneth Nyman	2,482	894	$5,629,074.88	750	$1,625,692.50	$7,254,767.38
Keith Johnson	1,190	1,894	$5,142,199.92	0	0	$5,142,199.92
Beverly Kiepler	577	0	$962,078.26	0	0	$962,078.26
Kristen Branch	123	0	$205,087.74	0	0	$205,087.74
Virginia W. Nyman	198	0	$330,141.24	0	0	$330,141.24
Virginia S. Nyman	88	0	$146,729.44	0	0	$146,729.44
Walfred Nyman Trust	1,677	0	$2,796,196.26	0	0	$2,796,196.26
TOTAL	**9,152**	**4,348**	**$22,509,630.00**	**1,500**	**$3,251,385.00**	**$25,761,015.00**
	13,500					

In addition, the defendants received approximately $5.1 million for what were referred to as their covenants not to compete against Van Leer. Robert received $1,792,337; Kenneth received $1,024,262; Johnson received $2,301,401.

The covenants were contained in the purchase and sale agreement which all three signed, in separate consulting agreements signed by Robert and Kenneth, and in an employment contract signed by Keith Johnson. The covenant in the purchase and sale agreement prohibited the defendants from running, owning, or being engaged in the management or control or ownership of any enterprise that competes with Van Leer, for a period of five years from the date of the agreement. The covenants in the consulting agreements and the employment

contract were somewhat broader. They prohibited the defendants from participating, in any capacity, in any business activity competing against Van Leer for at least five years.

Covenants not to compete and employment contracts or consulting agreements are fairly standard components of agreements to acquire a going business. In order to preserve the value of the business that was purchased and ensure a smooth transition, the buyer frequently contracts with the principals of the acquired company for their continued services and for their agreement not to compete for a specified period of time. Among the factors affecting the amount paid to the principals are the value of the business acquired and the extent to which that value might be diminished if the principals competed with it.

In this case, the plaintiffs have made no claim and have presented no evidence that the amount paid for the covenants was excessive. Nor does the sum of $5.1 million appear, on its face, to be unreasonable in order to obtain the continued services of the three principals of a company that was purchased for $28 million and to prevent them from competing.

What the plaintiffs are claiming is that the $5.1 million represented additional compensation to the defendants for their stock rather than payment for their covenants not to compete.

However, while there is ample reason to question how much of that money was attributable to the defendants' covenants not to compete, there is no evidence that any of it was a disguised form of payment for their stock.

The uncontradicted testimony of Keith Johnson, himself, was that the $5.1 million figure was arrived at by totaling Nyman Manufacturing's $2.3 million unfunded liability to the defendants under the 1996 deferred compensation plan and the $2.8 million in tax savings realized by Van Leer as a result of the defendants' agreement not to exercise their stock options.[4] Johnson suggested that part of the reason that Van Leer agreed to pass those savings on to the defendants was to compensate the defendants for the additional tax liability that they incurred by selling their options and being taxed on the gains at ordinary income rates, instead of exercising the options and selling the stock, in which case the gains would have been taxed at lower capital gains rates.

Although Johnson's explanation casts serious doubts on the characterization of the $5.1 million as payment for the defendants' covenants not to compete, there is no evidence that the $5.1 million was a disguised form of additional compensation

[4] According to Johnson, that agreement allowed Van Leer to deduct the amount paid for the options as a current expense rather than amortizing it over time as an investment in stock.

for the defendants' stock. On the contrary, the amounts that the defendants received were disproportionate to their stock holdings. Thus, Robert, Kenneth, and Keith Johnson received 35%, 20%, and 45%, respectively, of the $5.1 million. However, of the 12,337 shares and options belonging to the defendants, Robert owned 42%, Kenneth owned 33%, and Keith Johnson owned 25%. The disproportion becomes even greater if one takes into account the fact that some of the shares owned by Robert and Kenneth were Class B shares which were sold for 1.3 times as much as the Class A shares.

Therefore, this Court finds that the plaintiffs have failed to establish that the payments in question amounted to additional compensation for the defendants' stock.

II. The Value of the Stock

The main premises on which the plaintiffs' claim rests are that the redemption price that they were paid was less than the true value of their stock and that the defendants misrepresented and failed to disclose material facts regarding the value of Nyman Manufacturing stock as part of a scheme to defraud the plaintiffs. Therefore, the Court begins its inquiry by examining the value of the plaintiffs' stock in May 1996 when the defendants offered to and did, in fact, redeem that stock.

A. Financial or Fair Market Value

The evidence regarding the financial or fair market value of Nyman Manufacturing's stock in May of 1996 consisted of opinions expressed by Steven Carlson, the plaintiffs' valuation expert, and William Piccerelli, the defendants' valuation expert. This Court finds Piccerelli's testimony far more persuasive than Carlson's for a number of reasons.

First, Piccerelli's training and experience are far more impressive than Carlson's. Piccerelli is a certified public accountant who belongs to several professional organizations comprised of individuals who specialize in business valuations, including the National Association of Certified Valuation Analysts and the Business Valuation Committee of the Rhode Island Society of Certified Public Accountants. In addition, Piccerelli has had many years of experience in valuing businesses, an undertaking to which he devotes approximately 40% of this time. Carlson, on the other hand, has an accounting degree but has never actually practiced as an accountant. Moreover, he has had no formal training with respect to business valuation and does not belong to any professional organizations that are devoted to that subject. Furthermore, his experience in valuing businesses was much more limited than Piccerelli's and derived, primarily, from his work as a bank loan officer and, more recently, from informal valuations performed for

clients of Lang Associates.

Second, Piccerelli's approach was more consistent with generally accepted methods of business valuation, some of which Carlson was not familiar with. Moreover, although Carlson purported to utilize the standards set forth in a textbook by Shannon Pratt, the leading authority on the subject, he did not consistently apply those standards. For example, in applying the earnings method of valuation, Carlson used Nyman Manufacturing's earnings during a single year rather than over the five-year period recommended by Pratt.

Finally, Carlson made several miscalculations that required him to revise his valuation twice.

Accordingly, based on Piccerelli's calculations, this Court finds that, in May 1996, when the defendants offered to and did, in fact, redeem the plaintiffs' shares for $200 per share, the fair market value of the plaintiff's stock was $303.00 per share.

Since the plaintiffs allege that the defendants' receipt of options to purchase shares and their purchase of treasury shares at less than fair market value provides further evidence of a scheme to defraud them, this Court, also, will make findings regarding the value of Nyman Manufacturing stock on those dates. Those findings are that, on April 3, 1995, when Keith Johnson

was granted options to purchase 1,000 shares for $145.36 per share, the fair market value of Nyman stock was $124.00 per share; on November 6, 1995, when all of the defendants were granted options having an exercise price of $145.36 per share, the stock's fair market value was $207.00 per share; and, on June 25, 1996, when the defendants purchased the treasury shares for $200 per share and awarded themselves options having exercise prices ranging from $200-$220 per share, the stock had a fair market value of approximately $303.00 per share.

B. Strategic or Investment Value

There is no question that, by the late Spring of 1997, Nyman Manufacturing had a strategic or investment value of nearly $30 million, the purchase price specified in the letter of intent signed by Van Leer. As already noted, that meant that, after allowing for closing costs and expenses, the Class A shares and options then outstanding, including the options and treasury shares acquired by the defendants on June 25, 1996, were worth approximately $1,700 each, and the Class B shares were worth approximately $2,200 each.[5] These values are 8-10 times what the plaintiffs were paid for their stock. They also are many times greater than the exercise prices of the options that the

[5] Those values would be even higher if the options and shares acquired by the defendants on June 25, 1996, are excluded from the calculation.

defendants previously had acquired and/or the prices that they later paid for the treasury shares that they purchased. Consequently, the issue presented is whether the marked increase in value had occurred or was foreseeable by the defendants when they redeemed the plaintiffs' shares; and, if so, whether, in redeeming those shares, the defendants committed fraud and/or breached their fiduciary duties to the plaintiffs.

Conclusions of Law

I. The Securities Fraud Claim

A. The Applicable Law

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 of the Securities and Exchange Commission's regulations, make it unlawful to use any "instrumentality of interstate commerce" or "any national securities exchange:"

> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact, or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

In order to prevail on their securities fraud claim, the plaintiffs must prove that:

(1) the defendants used a means of interstate commerce or

the mails;
(2) the defendants either:
    (a) employed a device, scheme, or artifice to defraud, or
    (b) made an untrue statement of a material fact, or omitted to state a material fact which made what was said, under the circumstances, misleading, or
    (c) engaged in a fraudulent act, practice or course of business;
(3) the defendants acted knowingly, and with the intent to defraud or with reckless disregard as to whether it would mislead plaintiffs;
(4) the plaintiffs justifiably relied on the defendants statements or omissions; and
(5) the defendants' conduct caused injury to the plaintiffs.

See 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; Holmes v. Bateson, 583 F.2d 542, 551 (1st Cir. 1978).

The plaintiffs allege that the defendants knowingly misrepresented and/or failed to disclose material facts regarding the value of Nyman Manufacturing stock as part of a scheme to defraud the plaintiffs by inducing them to sell their shares for an amount less than their true value.

B. Alleged Misrepresentations

The plaintiffs' misrepresentation claim is based on statements contained in Keith Johnson's May 8, 1996 letter and statements made by Robert during his May 10, 1996 telephone conversation with Judith.[6]

[6] There is no evidence that Kenneth Nyman knew of the specific statements made by Keith Johnson or Robert Nyman, but evidence was presented that Kenneth participated in the decision to offer to redeem the Lawtons' shares for a price

1. The Johnson Letter

With respect to the Johnson letter, the plaintiffs rely on the following three statements:

1. That the approval for the redemptions given by Heller and CoreStates would expire on May 22, 1996.
2. That other minority shareholders had inquired about the possibility of having their shares redeemed.
3. That Nyman Manufacturing had experienced significant losses during five of the previous ten years.

Although the first two statements were demonstrably false, they were not material to the plaintiffs' decision to sell their stock. The third statement was neither false nor material.

A statement of fact is deemed "material" if it is one to which a "reasonable [person] would attach importance in determining his [or her] choice of action in the transaction in question." Restatement of Torts § 538(2)(a), quoted in Rogen v. Illicon Corp., 361 F.2d 260, 266 (1st Cir. 1966) (applying Rule 10b-5); Dowling v. Narragansett Capital Corp., 735 F. Supp. 1105, 1119 (D.R.I. 1990).

In this case, there is no evidence that the artificial deadline established by Johnson had any bearing on the plaintiffs' decision to sell their stock. The plaintiffs had

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based on the per-share price paid for the Magda Burt shares.

been exploring the possibility of a redemption for some time before receiving Johnson's letter and had an additional two weeks after receiving the letter and before the purported deadline in which to seek advice or additional information. Indeed, the promptness with which the plaintiffs accepted the redemption offer[7] and the fact that they made no effort to seek advice or additional information, even though Johnson's letter urged them to consult their financial advisors and Johnson always had been cooperative in furnishing any information that was requested, demonstrates that they did not rely on Johnson's statement in making their decision.

Nor is there any evidence that the plaintiffs were influenced or that any reasonable shareholder would have been influenced by the statement that other shareholders had inquired about the possibility of a redemption. That is particularly true under circumstances like these where there were a limited number of shareholders who were members of the same family and easily could communicate with one another.

The plaintiffs concede that Johnson's statement that the company had suffered significant losses during five of the ten previous years was true, but they argue that it conveyed a

[7] The plaintiffs agreed to resell their shares two days after the letter was sent and nearly two weeks before the "deadline."

deceptively negative impression regarding the value of their stock. That argument is patently without merit, especially since the very next sentence of Johnson's letter describes how the company's financial condition had improved during the two most recent years.

1. Robert's Statements

The plaintiffs also rely on the following statements made by Robert to Judith.

1. That the value of Nyman Manufacturing stock could go up or it could go down.

2. That the opportunity to sell could be a "once-in-a-lifetime" opportunity.

Neither of those statements is either factual or material. A statement that the value of stock could go up or could go down simply states the obvious possibilities and does not constitute any representation about the value of the stock. The statement that the opportunity to sell could be a once-in-a-lifetime opportunity also was nothing more than a statement of the obvious possibility that the plaintiffs might not have another chance to sell their stock at that price. No reasonable person could construe that comment as a factual statement regarding the value of the plaintiffs' stock.

C. The Alleged Omissions

Next in the plaintiffs' litany of claims is the claim that the defendants failed to disclose material facts bearing on the value of their shares. Specifically, they allege that Johnson's May 8 letter and Robert's statements to Judith omitted relevant information regarding Nyman Manufacturing's financial condition and the likelihood that the company would be sold.

1. Nyman Manufacturing's Financial Condition

A director who makes a statement of material fact to shareholders has a duty to make a complete disclosure of any other relevant facts that may be necessary to prevent the statement from being misleading. Roeder v. Alpha Indus., 814 F.2d 22, 26 (1st Cir. 1987) (citing Securities & Exchange Comm'n v. Texas Gulf Sulphur Co., 401 F.2d 833, 860-61 (2d Cir. 1968)); see also Dowling v. Narragansett Capital Corp., 735 F. Supp. 1105, 1119 (D.R.I. 1990). Omitting an additional fact is not fraudulent unless the omission makes what was stated misleading. See 17 C.F.R. § 240.10b-5.

The plaintiffs claim that Johnson's May 8 letter was deficient because it failed to disclose that the company had experienced "record" profits during the two preceding years and because it did not contain information regarding the company's improved financial condition. Those claims are without merit.

The May 8, 1996 letter explicitly stated that "In the two

most recent years, the Company's financial condition has improved. . . ." The defendants were not required to characterize the improvement as one that produced what the plaintiffs describe as "record profits." Indeed, if they had done so and the value of the company had declined, the plaintiffs, undoubtedly, would be accusing the defendants of overstating the value of the plaintiff's shares.

Nor were the defendants required to include in the May 8 letter more detailed information regarding the improvements in the company's financial condition. Although the information that they provided was very general, it was accurate and not misleading. If the plaintiffs desired further documentation or details regarding the improvements referred to by the defendants, they had a responsibility to say so. Absent a request, requiring the defendants to furnish voluminous documents confirming what they already have stated would require a simple offer to redeem shares to be accompanied by masses of unspecified data covering an indeterminate period of time, a proposition for which the plaintiffs have failed to provide any authority.

In any event, the alleged omissions did not render the statement in question misleading. On the contrary, as already stated, the "omitted" information supported the statement that

the company's financial condition had improved.

2. The Likelihood of a Sale

The Supreme Court has held that there is no bright-line rule for determining when the possibility of a merger rises to the level of a material fact that, under Rule 10b-5, must be disclosed, and that such decisions must be made on a case-by-case basis. See Basic Inc. v. Levinson, 485 U.S. 224, 238 (1988). The Court in Basic, Inc. held that, in such cases, "materiality" depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.' " Id. at 238 (quoting Securities & Exchange Comm'n v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc)).

Although Basic, Inc. dealt with a merger and alleged misrepresentations denying that merger discussions had taken place, as opposed to a sale and the failure to disclose relevant facts, its holding is equally applicable in the context of this case.

Here, there is no question that the sale of Nyman Manufacturing to a strategic buyer at a substantial premium over the company's market value would have been an event of

sufficient magnitude to make it material. The question is whether, on May 8, 1996, the likelihood of such a sale was great enough to convert it from a mere possibility to a material fact that had to be disclosed.

In assessing the probability that Nyman Manufacturing would be sold, one of the factors to be considered is the "indicia of interest in the [sale] at the highest corporate levels," id. at 239, as evidenced by such things as board resolutions, instructions to others, and actual negotiations. Id. The importance of actual negotiations cannot be overstated because, absent any negotiations, it would be difficult to describe the possibility of a merger as either material or as a fact. That point is underscored by the First Circuit's holding in Jackvony v. RIHT Financial Corp., 873 F.2d 411 (1st Cir. 1989), that even actual expressions of vague interest in a possible merger, without concrete offers of specific discussions with any particular company, were not material.

Although it is fairly clear that by May 8, 1996, the defendants anticipated the possibility that Nyman Manufacturing would be sold, see infra, at pp. 34-36, there is no indication that, at that time, a sale was anything more than a mere possibility. The plaintiffs presented no evidence of any board resolutions to sell the company, any instructions given to

others to effect a sale or any negotiations with Van Leer or other prospective buyers interested in purchasing the company. Consequently, the possibility of a sale had not yet ripened to a point at which disclosure would have been required under the securities laws.

II. Breach of Fiduciary Duty

A. The Nature of the Duty

Under Rhode Island law, in order to prevail on a breach of fiduciary claim, a plaintiff must establish that (1) the defendants owed the plaintiff a fiduciary duty (2) the defendants breached that duty and (3) the defendants' breach harmed the plaintiff. A. Teixeira & Co. v. Teixeira, 699 A.2d 1383, 1387 (R.I. 1997).

It is well established that corporate officers and directors owe a fiduciary duty of good faith and fair dealing to the corporation and its shareholders and that such duty imposes a standard of conduct that is "stricter than the morals of the marketplace." Ed Peters Jewelry Co. v. C & J Jewelry Co., 51 F. Supp. 2d 81, 98 (D.R.I. 1999). In the case of a closely held corporation, the duty is enhanced and has been described as one of "utmost good faith and loyalty ," Tomaino v. Concord Oil, Inc., 709 A.2d 1016, 1021 (R.I. 1998), which is "similar to [the duty] imposed upon partners in a partnership." A. Teixeira, 699

A.2d at 1388; Broccoli v. Broccoli, 710 A.2d 669, 673 (R.I. 1998).

The fiduciary duty of a corporate officer or director takes many forms. Among other things, it prohibits the fiduciary " . . . from acting 'when he has an individual interest in the subject matter,' " Ed Peters Jewelry Co., 51 F. Supp. 2d at 99 (quoting Point Trap Co. v. Manchester, 199 A.2d 592, 596 (R.I. 1964)), and from using "knowledge respecting the affairs and organization that are subject to the relationship to gain any special privilege or advantage over the other person or persons involved in the relationship." Slattery v. Bower, 924 F.2d 6, 9 (1st Cir. 1991) (applying Maine law).

When directors of a closely held corporation are purchasing a minority stockholder's shares, fiduciary duty imposes an obligation of "complete candor" to disclose "all information in their possession 'germane' to the transaction." O'Neal & Thompson, O'Neal's Close Corporations § 8.12 at 129 (3d ed. 1995 Supp.). The fiduciary duty of disclosure is more stringent and far reaching than the duty of disclosure imposed by the securities laws. Thus, corporate officers who contemplate a possible sale of the company must reveal that possibility to minority stockholders from whom they seek to purchase shares even though sale negotiations have not yet taken place. See

Mansfield Hardwood Lumber Co. v. Johnson, 263 F.2d 748, 756 (5th Cir. 1959).

B. The Alleged Breaches

The plaintiffs present a potpourri of ways in which they claim that the defendants breached their fiduciary duties. The alleged breaches range from the defendants' acquisition of options to purchase shares for less than their true value to giving the corporation unsecured notes for the purchase of treasury shares to redeeming the plaintiffs' shares without disclosing the possibility that Nyman Manufacturing would be sold.

1. The Options and Note

The plaintiffs' claim with respect to the options and note fails for several reasons.

First, the plaintiffs lack standing to assert those claims. Any loss resulting from the alleged inadequacy of the option prices and/or the note given for the purchase of treasury shares was a loss incurred by the corporation and borne ratably by all shareholders. Consequently, it would have to be asserted in a derivative action brought on behalf of the corporation. See Halliwell Assocs., Inc. v. C.E. Maguire Servs., Inc., 586 A.2d 530, 533 (R.I. 1991) ("Where there is no showing that plaintiff himself had been injured in any capacity other than in common

with his fellow stockholders, the cause of action belongs to the corporation, and a stockholder may not seek relief on his own behalf.").

Moreover, the November 6, 1995, options to purchase 2,256 shares of stock did not affect the plaintiffs' interest in Nyman Manufacturing. Those options were awarded in connection with the redemption of an equal number of shares belonging to the estate of Magda Burt. The net result of that redemption and the contemporaneous award of options to the defendants which they later sold as shares, was a transfer of the estate's interest to the defendants. Consequently, those transactions did not diminish the plaintiffs' percentage ownership or the value of their shares, and any claim that the Burt shares were redeemed and that the defendants eventually acquired them for less than their true value would belong to the Burt estate or its beneficiaries as the parties who suffered the loss.

Although the April 3, 1995 award to Keith Johnson of options to purchase 1,000 Class A shares of Nyman Manufacturing stock did diminish the plaintiffs' interest in the company, even Ronald Lang, the plaintiffs' own expert witness, conceded that there was nothing improper about that award. There were legitimate business reasons for granting those options. Johnson was induced to accept employment at Nyman Manufacturing by the

promise of an equity stake in the company if he could help turn the business around, and he accepted a lesser salary in reliance on that promise. Furthermore, Johnson upheld his end of the bargain. When the options were granted, the company's performance had improved due, largely, to Johnson's efforts.

In any event, the exercise price of $145.36 per share actually exceeded the value of the shares at that time. The fair market value of Nyman stock was only $124.00 per share, and the prospect of a future sale of the company to a strategic buyer was, at most, nothing more than a remote possibility. Indeed, if such a sale had been considered likely, it would be difficult to understand why the Nyman brothers also did not award options to themselves.

2. The Redemption of Plaintiffs' Shares

Whether the defendants breached their fiduciary duties by redeeming the plaintiffs' stock for $200 per share turns on whether, at the time of redemption, they had a realistic expectation that Nyman Manufacturing might be sold.

As already noted, the fiduciary duty of disclosure imposed on a director of a closely held corporation who seeks to purchase the shares of a minority stockholder is broader than the disclosure obligations created by the securities laws. A fiduciary's duty to disclose a potential merger or sale of the

corporation is not limited to transactions for which negotiations already are underway. It also encompasses transactions that the directors anticipate are reasonably likely to occur or that are something more than remote possibilities.

In this case, it is clear that, when they redeemed the Lawtons' shares, the defendants knew that a sale of the company to a strategic buyer was a distinct possibility. The redemption offer was made after the defendants, for the first time in the company's history, had adopted and begun implementing plans to repurchase the stock owned by other shareholders and to award themselves options to purchase additional shares. The redemptions represented a marked departure from the company's previous lack of interest in purchasing stock owned by the Burt estate and they were made at a time when the company needed funds to meet its operating expenses. Furthermore, the plan to begin redeeming shares was adopted at about the same time that the board authorized Johnson to hire a consultant. Although Shields & Co. was not formally retained until August of 1996, its retention letter makes clear that one of its duties was to explore the possibility of selling the company and that Van Leer had been identified as a potential buyer.

Additional indications of the defendants' suddenly strong and, otherwise, inexplicable interest in acquiring more shares

may be found in the urgency with which they sought to redeem the Lawton and Kiepler shares as shown by the artificial deadlines established for responses to the redemption offers.

Moreover, for reasons stated in Kiepler, the expectation that Nyman Manufacturing would be sold provides the only plausible explanation for the defendants' purchase of treasury shares less than one month after redeeming the plaintiffs' shares. See Kiepler v. Nyman, C.A. No. 98-272-T, at pp. 27-30.

All of these facts lead this Court to conclude that on May 8, 1996, when the defendants offered to buy back all of the plaintiffs' shares, they anticipated that the company soon could be sold for much more than the amounts that they paid for those shares. Failing to disclose that possibility to the plaintiffs was a breach of the defendants' heightened fiduciary duties to plaintiffs.

III. The Remaining Claims

There is no need to prolong matters by parsing through the multitude of alternative theories under which the plaintiffs seek relief. The claims for common law fraud, negligent misrepresentation and unjust enrichment add nothing. Moreover, to the extent that those claims are based on alleged misrepresentations or failures to disclose material facts, they fail for the same reason that the securities law claim fails.

IV. The Remedy

A. Compensatory Damages

Defendants who breach their fiduciary duty may be held liable for any resulting loss sustained by the parties to whom the duty is owed. Ed Peters Jewelry Co. v. C & J Jewelry Co., 51 F. Supp. 2d 81, 99 (D.R.I. 1999); Restatement (Second) of Torts § 874 cmt. b. The defendants, also, may be required to disgorge any additional profits that they realized from the breach. See Ed Peters Jewelry Co., 51 F. Supp. 2d at 99; Restatement (Second) on Torts § 874 cmt. b. However, each party to whom the duty was owed is entitled to recover or to impress a constructive trust upon only its proportionate share of those additional profits. Securities Exchange Comm'n v. P.B. Ventures, Civ. A. No. 90-5322, 1991 WL 269982, at *3 (E.D. Pa. Dec. 11, 1991); see Ed Peters Jewelry Co., 51 F. Supp. 2d at 99; Matarese v. Calise, 305 A.2d 112, 119 (R.I. 1973).

In this case, the measure of the plaintiffs' loss is the difference between the true value of their shares at the time of redemption and the amount that they received for those shares. Since, in May of 1996, it was not certain that Nyman Manufacturing would be sold, it is impossible to calculate precisely the strategic value of the plaintiffs' stock at that time. The best indication of that value is the fact that,

approximately one year later, Van Leer agreed to purchase Nyman Manufacturing for an amount that would have yielded a price of $2,486.59 per Class A share and $3,232.56 per Class B share. See Kiepler v. Nyman, C.A. No. 98-272-T, at p. 31. Moreover, it is reasonable to conclude that, if the possibility of a sale had been disclosed, the plaintiffs would not have sold their shares for $200 each; but, rather, would have held on to them in the hope that the sale would take place.

In either event, the defendants' failure to disclose the possibility of a sale resulted in the plaintiffs receiving $183,400.00 for their 917 shares[8] instead of the $2,280,198.48 that they otherwise would have received,[9] a loss of $2,096,798.48.

Similarly, the remaining shareholders would have received $6,621,775.96 for their 2,663 shares of Class A stock at the sale to Van Leer,[10] instead of the $4,440,232.94 that they

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[8] At $200 per share, the plaintiffs' 917 Class A shares were redeemed for $183,400.00.

[9] At $2,486.59 per share, the plaintiffs' 917 Class A shares would have been worth $2,280,198.48 at the sale to Van Leer, had the defendants not purchased the treasury shares in June 1996.

[10] At $2,486.59 per share, the remaining shareholders' 2,663 Class A shares would have been worth $6,621,775.96 at the sale to Van Leer, had the defendants not purchased the treasury shares in June 1996.

actually received,[11] a loss to them of $2,181,543.02. Thus, the combined loss suffered by the plaintiffs and all other shareholders was $4,278,341.50.

That loss is identical to the profit realized by the defendants. As stated in Kiepler, it was a breach of fiduciary duty for the directors to have purchased the treasury shares. If they had not purchased the treasury shares and had not obtained options to purchase the wrongfully redeemed Lawton shares, they would have received only $16,859,046.56 at the sale to Van Leer,[12] instead of the $21,320,788.06 that they actually received.[13] Therefore, as a result of their breach of fiduciary duty, the defendants realized a gross profit of $4,461,741.50. Although that gross profit is $183,400.00 more than the loss suffered by the Lawtons and other shareholders, the net profit

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[11] At $1,667.38 per share, the remaining shareholders' 2,663 Class A shares were actually sold to Van Leer for $4,440,232.94.

[12] Had the defendants not caused the plaintiffs to redeem their shares and not purchased the treasury shares, they would have owned 5,805 Class A shares and options to purchase Class A shares, and 750 Class B shares. At $2,486.59 per Class A share/option and $3,232,57 per Class B share, this would have resulted in a total of $16,859,046.56 in gross proceeds.

[13] At the sale to Van Leer, the defendants owned 6,489 Class A shares and 4,348 options to purchase Class A shares, and 1,500 Class B shares. At $1,667.38 per Class A share/option, and $2,167.59 per Class B share, this generated $21,320,788.06 in gross proceeds.

realized by the defendants is actually less than the other shareholders' losses, because the defendants had to pay Van Leer exercise prices ranging from $200-$220 per share for the 1,092 June 25, 1996 options. While there is no way to calculate exactly how much exercising 917 of those options cost the defendants, even if all 917 of the Lawtons' former shares carried an exercise price of $200 per share, the lowest exercise price for the June 25 options, that would have cost the defendants exactly $183,400.00.

Therefore, the defendants did not make any "additional" profits that must be disgorged, and the amount recoverable as damages is the same as the amount that the defendants would be required to disgorge.

B. Punitive Damages

Under Rhode Island law, punitive damages is "an extraordinary sanction and is disfavored." Palmisano v. Toth, 624 A.2d 314, 318 (R.I. 1993) (citing D'Amato v. Rhode Island Hosp. Trust Nat'l Bank, 772 F. Supp. 1322, 1324 (D.R.I. 1991)). In order to recover punitive damages, the plaintiffs must show that the defendants acted with "such willfulness, recklessness, or wickedness . . ., as amount[s] to criminality, which for the good of society and warning to [the defendants], ought to be punished," id., or "with malice or in bad faith" and with "the

intent to cause harm." Id.

In this case, the plaintiffs have failed to sustain that heavy burden. Although the defendants anticipated the possibility that Nyman Manufacturing would be sold and their heightened obligations as fiduciaries required them to disclose that possibility, the evidence is insufficient to establish that they acted with the requisite degree of criminality or malice or even that they acted fraudulently.

Conclusion

For all of the foregoing reasons, it is hereby ordered that, with respect to the breach of fiduciary duty claim, judgment be entered in favor of the plaintiffs and against the individual defendants, jointly and severally, in the following amounts:

Judith A. Lawton:	$1,335,365.66	
Thomas Lawton:		$201,219.48
Marsha E. Daras:	$80,030.48	
Stephen H. Lawton:	$80,030.48	
Nancy J. Cronin:	$80,030.48	
David T. Lawton:	$80,030.48	
T. Michael Lawton:	$80,030.48	
Joanna J. Lawton:	$80,030.48	
Suzanne M. Lawton:	$80,030.48	
TOTAL	$2,096,798.50;	

and that the plaintiffs be awarded prejudgment interest at 12% per annum, from May 8, 1996, pursuant to Rhode Island General Laws § 6-26-1. The remaining claims against these defendants and the corporation are dismissed.[14]

IT IS SO ORDERED,

Ernest C. Torres
Chief Judge
Date: , 2002

[14] The claims against the corporation for breach of fiduciary duty and unjust enrichment were, previously, dismissed by an order dated August 24, 1999.

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